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No. 777

In the Supreme Court of the United States

October Term, 1949.

LOLA BROOKS, ADMINISTRATRIX OF THE ESTATE OF F. S. BROOKS, DECEASED,
Petitioner,

vs.

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, A MISSOURI CORPORATION,
Respondent.

Petition for Writ of Certiorari, and Brief in Support Thereof.

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Dated April 25, 1950.

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IN THE SUPREME COURT OF THE UNITED STATES.

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LOLA BROOKS, ADMINISTRATRIX OF THE ESTATE OF F. S. BROOKS, DECEASED,

Petitioner,

vs.

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, A MISSOURI CORPORATION,

Respondent.

PETITION FOR WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS, EIGHTH CIRCUIT.

Lola Brooks, administratrix of the estate of F. S. Brooks, deceased, (hereinafter called petitioner) prays that a writ of certiorari issue to review the judgment (R. 49)[1] of the United States Court of Appeals, Eighth Circuit, entered March 3, 1950, affirming an order of the United States District Court for the Eastern District of Missouri (R. 33), in proceedings for the reorganization under Section 77 of the Bankruptcy Act of St. Louis-San Francisco Railway

1. The record accompanying this Petition pursuant to Rule 38, par. 2, will be referred to herein as (R. .....).

Company, debtor, deciding that the claim of petitioner against the debtor (hereinafter called respondent) is not entitled to priority over its respective mortgages.

Opinions Below.

The opinion of the Court of Appeals (R. 43) is reported at 180 F. (2d) 185. The order denying this petitioner's petition for rehearing (R. 59) is not yet reported. The opinion of the District Court (R. 31) has not been reported.

Jurisdiction.

The judgment of the Court of Appeals was entered March 3, 1950. This petitioner's petition for rehearing was denied March 23, 1950. The jurisdiction of this Court is invoked under Article III, Section 2 of the Constitution and Title 28, United States Code, Section 1254(1).

Statute Involved.

The provisions of Section 77 of the Bankruptcy Act requiring examination are set forth in the Appendix to this petition.

Questions Presented.

ONE.

In equity, is a claim against a railroad company for damages for personal injuries caused to a non-employee by its negligence in operation, while solvent, entitled to payment from its current income in priority over indebtedness secured by pre-existing general mortgages on its estate which provide that current income shall be applied to payment of operating expenses before it is applied to payment of currently maturing indebtedness upon the mortgages?

Two.

In proceedings under Section 77 of the Bankruptcy Act, is the claim described in Question One entitled to priority over the remaining mortgage indebtedness, where the debtor's operating income during solvency, was sufficient to pay the claim, but has been applied to payment of currently maturing indebtedness upon the mortgages, leaving the claim unpaid?

Statement.

Respondent, on July 1, 1916, and on March 1, 1928, respectively, executed the general mortgages upon its estate which here are involved (R. 10, 13). Both mortgages include operating income, provide that until default the mortgagor shall remain in possession of the estate and shall collect and use the income, and that:

> "The railway company covenants and agrees that from such income, after payment of the operating and maintenance expenses of the mortgaged premises embraced in the trust estate"

interest maturing upon the mortgage indebtedness shall be paid (R. 11-12).

January 10, 1930, petitioner's intestate, a non-employee, sustained an injury to his person from the negligent operation by respondent of one of its trains (R. 19-20).

The Interstate Commerce Commission by order establishing regulations effective July 1, 1914, provided that the classification of operating expenses of steam roads shall include expenses on account of injuries to persons occurring directly in connection with transportation service which shall be accounted for as such (R. 10, 13-14). Respondent, in accordance with these regulations, recorded upon its books, and included in its accounting for each year,

as operating expenses, in an account titled "Reserve for Personal Injury and Suits Pending," its estimated liability for damages for such personal injuries accruing during the year, and its estimated liability upon the claim of petitioner was one of the items included in this accounting of operating expenses (R. 10, 16-17 and 22, 28-29).

Claims for personal injury and death were customarily paid by respondent out of its operating revenues (R. 10, 18).

In the years 1930 and 1931 respondent was solvent, its financial position being that reflected by the tabulation:

Year	*Net Available for Interest*	*Dividends Paid*	*Surplus Remaining*
1930	$18,406,000	$ 8,184,068	$17,550,253
1931	10,075,000	6,643,274	9,909,589

During the two years also a total of $32,569,690.48, was expended for maintenance, structures and betterments (R. 1, 2-4).

All interest maturing upon the mortgages prior to January 1, 1933, was paid. No default upon them occurred before that date (R. 1, 2-3). November 1, 1932, at the instance of others than the mortgagees the mortgaged estate was placed in receivership (R. 1, 3).

No action was taken to foreclose the mortgages until March 6, 1933, nor to sequester the income for the benefit of the mortgagees until May 1, 1933.

January 23, 1933, petitioner's intestate obtained in a state court a judgment for $4,000, interest and costs against respondent, with the consent of its receivers, for his damages on account of the personal injury, and filed with the receivers his claim therefor, to which petitioner has succeeded, and the receivers or the successor trustees in bankruptcy paid upon the claim, for costs, $2.30, but no more

(R. 1 and 19, 20-21). The reorganization proceeding under Section 77 of the Bankruptcy Act was commenced May 17, 1933, therein the claim of petitioner was ordered to be treated as refiled with the trustees, and by petition of intervention therein petitioner here asked that the claim be adjudged to have equitable priority over those under the mortgages and to be paid accordingly. Upon motions filed by petitioner and by respondent, respectively, for summary judgment upon the petition of intervention, the District Court, in the order affirmed by the Court of Appeals (R. 33), held as above has been recited.

Reasons for Allowance of the Writ.

1. The questions presented are purely of law, no appreciation of evidence being required for their decision. They are essentially Federal questions. That they must arise in the administration of every proceeding under Section 77 of the Bankruptcy Act is reasonably certain, since claims of the category to which that of petitioner belongs inevitably appear for disposition in the reorganization of insolvent railroads, which, with respect both to subject-matter and number of individual interests involved, has constituted for nearly three-quarters of a century one of the major functions of Federal courts.

It appears that this Court has never been called upon to decide in litigation of railroad reorganization the issue of priority between a claim for damages for personal injury arising from operation and indebtedness secured by a pre-existing mortgage, either where, as here, the mortgage itself provided for postponement of the mortgage debt to expenses of operation, and pre-insolvency diversion of income was alleged, or where some other factual situation was shown. The issue was incidental but was not adjudi-

cated in *Carpenter* v. *Wabash Ry. Co.*, (1940) 309 U. S. 23, which involved the claim of an employee injured in operation before the enactment of the amendment of August 11, 1939, to subsection (n) of Section 77 of the Bankruptcy Act, extending the provisions of that subsection to equity receiverships. The cause was in this Court upon certiorari to the Court of Appeals, Eighth Circuit, which, denying priority to the injured claimant's judgment for damages, had said:

> "But apart from whether judgments of this nature normally have, or may have, priority rights over antecedent mortgage liens, we believe appellant is foreclosed by this record from asserting such rights in this action."
>
> —*Carpenter* v. *Wabash Ry. Co.*, (1939) 103 F. (2d) 996, 1000.

After petition for certiorari was filed, the mentioned amendment to subsection (n) had been enacted, and this Court granted the writ and, conformably with the legislation, reversed the judgment. This Court, noticing the question of non-statutory equitable priority originally present in that case, said at pages 26-27:

> "For the present purpose, we may assume, without deciding, that the determination of the court below was correct upon the record before it * * *. We have held that earnings, while a railroad is in possession of the court and operated by its receivers 'are not necessarily and exclusively the property of the mortgagees' but are subject to the payment of claims which have superior equities as these may be found to exist. (Citing *Fosdick* v. *Schall*, 99 U. S. 235, and *Hale* v. *Frost*, 99 U. S. 389.) Claims having such equities may be accorded priority in payment although they arose prior to the receivership."

This seems to be the sole utterance of this Court upon

the point. The questions here squarely raised should be settled now by this Court.

2. The Court of Appeals based its judgment of affirmance upon the precedent and the doctrine of *St. Louis Trust Co.* v. *Riley,* (8th Cir., 1895) 70 F. (2d) 32, 36, that

> "It is an indispensable element of every such claim that it is founded upon property furnished or services rendered to the mortgagor which either preserved or enhanced the security of the mortgage debt, and thereby inured to the benefit of the mortgagee,"

and held:

> "Since we hold that her claim never was entitled to priority as an operating expense because the negligence resulting to her decedent not only did not inure to the benefit of the then existing mortgagees but was a detriment to them, there could be no diversion by the receivers or the trustees of any fund to which she had a prior right." (R. 43, 49)

The *Riley* case, which the Court of Appeals, upon our application (R. 35, 36), refused to re-examine and to overrule, is the precedent from which have developed all the decisions in the Eighth Circuit not only, but also in other circuits adopting the rule stated in the immediately preceding quotations. Avoidance of unjust enrichment, according to these cases, is the exclusive object of judicial power to award preference to claims for operating expenses.

On the other hand, this Court has defined with utmost clarity the basis of such judicial power:

> "The power rests upon the fact, that in the administration of the affairs of the company the mortgage creditors have got possession of that which in equity belonged to a whole or a part of the general creditors."
>
> —*Fosdick* v. *Schall,* (1879) 99 U. S. 235, 254.

And, referring to *Fosdick* v. *Schall*, decided when the subject of equitable priority between claims for operating expenses and those secured by mortgage was *res integra* here:

> "All we then decided, and all we now decide, is, that if current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use."
>
> —*Burnham* v. *Bowen*, (1884) 111 U. S. 776, 783.

As pointed out in the Petition for Rehearing below (R. 51), the benefit which is indispensable to the power to award priority to a claim for operating expense, relates, under the decisions of this Court, to the nature of the use by the mortgagor of operating income; but under the decisions in the circuits mentioned, the indispensable benefit relates to the nature of the operating expense upon which the claim is based.[2]

---

2. Illustrative is *In re New York, N. H. & H. R. Co.*, (2d Cir., 1937) 92 F. (2d) 428, 430, cert. den. 303 U. S. 650, in which that court said:

> "In *Burnham* v. *Bowen*, 111 U. S. 776, 783, 4 S. Ct. 675, 679, 28 L. ed. 596, Chief Justice WAITE concluded by saying that only those expenses should have priority which were 'for the benefit of mortgage creditors,' language which has been accepted several times since."

The misconception of this Court's language and decision seems obvious. Still, the case from the Second Circuit is cited as persuasive by the District Court which decided this case solely in deference to precedents and against its own expressed inclination and reasoning (R. 31-33), and by the Court of Appeals, which uses language (R. 46) substantially identical with that in the case from the Second Circuit ascribing to this Court the adoption, in the *Burnham* case, of the doctrine, which, in fact, was first announced in the *Riley* case. The conclusion in the *Riley* case was reached after review of 17 decisions of this Court, including *Fosdick* v. *Schall*, in six of which priority was awarded and in the rest was denied to a non-mortgage claim, "not one of them," as is said by Chief Justice BLECKLEY, reaching an opposite conclusion to that in the *Riley* case, in *Green* v. *Coast Line Ry. Co.*, (1895) 97 Ga. 15, 24 S. E. 814, 823, "involving a tort prior to the appointment of a receiver." None of the 17 expresses the doctrine of the *Riley* case.

Thus, for the equity declared by this Court to be the basis upon which priority may be awarded to claims for operating expenses, there has been substituted by the decisions in the *Riley* case and the cases which have followed it, an entirely different equity. This substitution the Court of Appeals has reaffirmed in the case at bar, and its conclusion, consequently, is in conflict with applicable decisions of this Court.

As is suggested by the opinion of the District Court below (R. 31, 32), the conflict between the opposed theories as to which, in reality, is the governing equity, should be settled by this Court.

3. To avoid the possibility of transgressing the rule requiring a petition for writ of certiorari to clearly, completely and definitely expose the controversy, mention is made of the statement in the opinion of the Court of Appeals (R. 48) with reference to Section 77(n) that:

> "Since the statute is jurisdictional in its application to claims for priority in receiverships, the rule is that the affirmative description of jurisdiction implies a negative of the exercise of similar powers not comprehended within the statute."

This statement seems unrelated to the issue actually decided by the Court of Appeals and upon which it affirmed the order of the District Court, by holding that since the claim of petitioner originated, not in benefit, but in detriment, to the mortgagees, it lacked the indispensable quality required to entitle it to priority.

Manifestly, the claim of petitioner is without statutory priority under subsection (n); but if the quoted language implies that her claim, because of the failure of subsection (n) to embrace it, is by that failure interdicted from prior-

ity, whatever the facts respecting it may be, it must be said that the implication is negatived by subsection (b) of the statute itself, which preserves the rights of priority existing at the commencement of the proceeding.

The claims embraced in subsection (n) are required to be preferred against all assets and irrespectively of whether there has been diversion of income or not. "The statute is explicit and mandatory and the District Court has no discretion to act contrary to its terms." *Carpenter* v. *Wabash Ry. Co.*, 309 U. S. 23, 29, *supra.* That subsection (n) is without relevancy, express or implied, to the claim of petitioner is clear.

Conclusion.

We respectfully submit that a writ of certiorari should be granted.

PHIL W. DAVIS, JR.,
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Counsel for Petitioner.

APPENDIX.

Section 77, Bankruptcy Act (Act of March 3, 1933, c. 204, Sec. 1, 47 Stat. 1474; amended Aug. 27, 1935, c. 774, 49 Stat. 911; June 26, 1936, c. 833, 49 Stat. 1969; Aug. 11, 1939, c. 689, 53 Stat. 1406; Title 11, U. S. C. A., Sec. 205):

"(b) * * * For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors.***."

"(n) In proceedings under this section, and in equity receiverships of railroad corporations now or hereafter pending in any court of the United States, claims for personal injuries to employees of a railroad corporation, claims of personal representatives of deceased employees of a railroad corporation, arising under state or Federal laws, and claims now or hereafter payable by sureties upon supersedeas, appeal, attachment, or garnishment bonds, executed by sureties without security, for and in any action brought against such railroad corporation or trustees appointed pursuant to this section, shall be preferred and paid out of the assets of such railroad corporation as operating expenses of such railroad. * * *"

PETITIONER'S SUPPORTING BRIEF.

Specifications of Error.

The Court of Appeals below erred in failing to hold that:

I.

The liability of a railroad for damages for personal injury caused to a non-employee by its negligence in operation is a necessary expense of operation.

II.

Current operating income of a mortgaged railroad accruing before the mortgagees acquire possession or its equivalent are subject to the payment of non-mortgage liabilities for current expense of operation in preference to the debt secured by the mortgages.

III.

The use by a mortgaged railroad, prior to its insolvency, of its current operating income to pay mortgage indebtedness, to the exclusion of a liability for a current expense of operation, is a diversion which results in priority to such liability over the mortgage debt when the railroad becomes the subject of equitable administration.

Argument and Authorities.

I.

In *In the Matter of Chicago, R. I. & P. Ry. Co., Debtor, Wise, et al., Appellants,* (7th Cir., 1937) 90 F. (2d) 312, cert. den. 302 U. S. 717, the court upheld the constitutionality of Bankruptcy Act, Section 77(n), and awarded preference to the claim of a non-employee who had obtained, for damages for personal injuries, a judgment which had become payable by a surety on appeal. Although subsec-

tion (n) was there applicable, the decision as to its constitutionality is based upon the reasoning of the court expressed:

> "The Court, in operating a railroad, must do what the company would have been bound to do if it had remained in possession, pay out of what it receives from earnings all debts, which, in equity and good conscience, considering the character of the business, are chargeable against the earnings." (p. 315)
>
> • • • • • • • •
>
> "The classification of claims as proper to be paid as current expenses from current income is based not upon the bankruptcy act but upon the inherent rules of equity. Congress made no provision for the allowance of priority of current expenses in equity cases, but the Supreme Court found that equity itself demands such classification. • • •
>
> • • • • • • • •
>
> "Let us examine the character of the claims. Though the suits are upon the supersedeas bonds • • • appellant was injured by the negligence of the railroad company in the operation of its trains. • • • Human care and judgment have never been able to eliminate accidents and consequent hurts to persons and property in such a hazardous business as that of operating a railroad. Injuries to the public from negligence are unfortunately far from infrequent • • •. In the very nature of things these risks and events attach to, emanate from and grow out of the process of earning income. They partake of the nature of operating expenses, and therefore, may be classified by Congress as such expenses, payment for which from the income before payment to the mortgagee is only equitable.
>
> "The question of unreasonable and arbitrary classification is one arising upon the specific facts before us, which disclose that the debts to appellants were originally incurred in the earning of the income upon

which the mortgagee claims a lien. Having been incurred in the process of earning income, they partake of the nature of operating expenses and are not unreasonably classified as such * * *." (p. 316)

The doctrine observed in the state courts is that stated by the Court of Appeals, Seventh Circuit:

Smith v. *Eastern R. Co.*, (1876) 124 Mass. 154, 156-157;

Green v. *Coast Line R. Co.*, (1895) 97 Ga. 15, 24 S. E. 814;

McCullough v. *Union Traction Co.*, (1933) 206 Ind. 585, 186 N. E. 300.

II.

An unbroken line of decisions of this Court, beginning with *Gilman* v. *Illinois and Mississippi Telegraph Co.*, (1876) 91 U. S. 603, establishes the priority, as to pre-receivership income, of operating expenses over mortgage debts.

"The substance of these rulings is that until the mortgagee asserts his rights under the mortgage to the possession of the road by filing a bill of foreclosure, or, if the road be in the hands of a third party, by demanding possession of such party, he has no right to its earnings and profits."

—*United States Trust Co.* v. *Wabash Western Ry.*, (1893) 150 U. S. 287, 308.

III.

"* * * In a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and stockholders; and if they give to one class of creditors that which properly belongs to another, the court may, upon an adjustment of the accounts, so use the income which comes into its own

hands, as, if possible, to restore the parties to their original equitable rights."

—*Fosdick* v. *Schall*, (1879) 99 U. S. 235, 254.

Upon the reasoning of the Court of Appeals, Seventh Circuit, in the *Wise* case, *supra*, it must be true that where no statutory mandate such as subsection (n) requires the payment of a personal injury claim, but diversion of income from its payment has occurred, an equity specifically protected by subsection (b) arises and entitles the personal injury claim to priority payment.

Conclusion.

We respectfully submit that the writ of certiorari should be granted and that upon review the judgment of the Court of Appeals, Eighth Circuit, should be reversed.

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CHELSEA O. INMAN,
Counsel for Petitioner.

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LOLA BROOKS, Administratrix of the Estate of F. S. Brooks, Deceased,
Petitioner,
vs.
ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, a Missouri Corporation,
Respondent.

No. 777.

BRIEF

In Opposition to Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

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IN THE

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vs.

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Respondent.

No. 777.

BRIEF

In Opposition to Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Respondent emerged from reorganization under Section 77 of the Bankruptcy Act by virtue of a Consummation Order and Final Decree entered December 12, 1946, by the District Court of the United States for the Eastern District of Missouri. In said Consummation Order and Final Decree jurisdiction was reserved to the Court to pass on any undetermined claims theretofore filed for priority over mortgages existing on the debtor's property (R. 7). In

the reorganization the interests of the old stockholders were entirely wiped out. They were allowed no interest whatever in the reorganized company. Likwise, all ordinary unsecured claims were wiped out and no interest was allowed to the holders thereof in the reorganized company. The assets of the old company were found insufficient to satisfy in full all claims secured by mortgages. See **St. Louis-San Francisco Ry. Co. Reorganization,** 257 ICC 399, 409-410, 435 (1944), and **In re St. Louis-San Francisco Ry. Co.,** 59 FS 417, at 419 (D Ct Mo, 1945), affirmed in **Brooks v. St. Louis-San Francisco Ry. Co.,** 153 F 2d 312; certiorari denied, 328 US 867, 868.

The claim at bar is an unsecured claim which petitioner asserts is entitled to priority. The origin of the claim and its disposition in the Court below are hereinafter set forth.

OPINIONS BELOW.

The opinion of the District Court dated June 29, 1949, is unreported. It appears in the Record at pages 31 and 33. The opinion of the Court of Appeals dated March 3, 1950, is reported in 180 F 2d 185. It appears in the Record at pages 43-49.

JURISDICTION.

The petitioner invokes the jurisdiction of this Court under Article III, Section 2, of the Constitution, and Title 28, United States Code, Section 1254 (1).

STATUTE INVOLVED.

Section 77 of the Bankruptcy Act governs the proceedings in which the claim at bar arose. The relevant subsections of said Section 77 are subsection (b) and subsection (n). The relevant portion of subsection (b) appears on p. 4 and subsection (n) is printed in the Appendix to this Brief.

QUESTION INVOLVED.

The question involved in this case is whether a claim for personal injury sustained prior to the bankruptcy of a railroad company by a claimant who was neither an employee nor a passenger of the debtor is entitled to priority of payment over claims secured by pre-existing mortgages on the debtor company's properties.

THE RELEVANT FACTS.

The claim arose out of a collision on January 30, 1930, at a highway-railroad grade crossing between one of the Railway Company's trains and an automobile which Brooks was driving (R. 37). Brooks reduced his claim to a judgment against the St. Louis-San Francisco Railway Company for $4,000 in a Missouri court on January 23, 1933, by consent of receivers who had been appointed in November, 1932, for the Railway Company's property (R. 38). Later the receivership was supplanted by proceedings for reorganization under § 77 of the Bankruptcy Act. No judgment was ever entered, by consent or otherwise, against the receivers or their successor trustees. In the reorganization proceedings the claim on the judgment was allowed as an unsecured claim (R. 2). Brooks later died, and his administratrix, petitioner here, moved the District Court to allow the unsecured claim in priority over the Railway Company's pre-existing mortgages, constituting liens on all its properties and income (R. 9).

The District Court denied the motion to allow the claim as one having priority over the mortgages (R. 33) and the Court of Appeals affirmed the order of the District Court (R. 50).

ARGUMENT.

POINT I.

The Judgment of the Court of Appeals Affirming the Order of the District Court Was in Accordance With Law, and No Ground for Granting a Writ of Certiorari to Review That Judgment Has Been Shown.

The petitioner's right to an allowance of this unsecured claim in priority over mortgages of the Railway Company is governed by subsection (b) of Section 77 of the Bankruptcy Act which makes the law of equity receiverships applicable to such claim. It provides:

> "For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the Debtor had been appointed by a Federal Court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors."

It is a basic principle of the law that unsecured claims against a debtor may not be satisfied or paid in priority over a mortgage on the debtor's property, out of assets subject to the mortgage, upon its foreclosure.

An exception to that fundamental principle was created in equity receiverships and on equitable grounds in **Fosdick v. Schall**, 99 US 235 (1878), in which the opinion was delivered by Mr. Chief Justice Waite. Shortly thereafter, in 1884, in **Burnham v. Bowen**, 111 US 776, at 783, he explained that only those expenses which were **"for the benefit of mortgage creditors"** fell within the exception to the rule that unsecured claims generally are subordinate to mortgage liens. And, as the Court below pointed out, "it is probable that he used the term 'current debts made in

the ordinary course of business' in the opinion in **Fosdick v. Schall,** supra, in the same sense, for in that case priority was denied a claim for rental for cars over the lien of an antecedent debt."

Since claims arising out of the negligence of the debtor are not for the benefit of the mortgage creditors, but rather a detriment to them, it has been uniformly held in the federal courts that such claims remain in the general class of unsecured claims which are subordinate to liens on the debtor's property. They are not within the exceptional class recognized in **Fosdick v. Schall,** because not within the reason and equity on which that class rests. The rulings of the federal courts on this question are set forth in the opinion of the Court below (R. 46-47). The decision in **St. Louis Trust Co. v. Riley,** 70 F 32, holding that a personal injury claim based on the negligence of the debtor is not entitled to priority, was, as Judge Learned Hand said, "unquestionably the law when Section 77 was passed." **In re New York, New Haven & Hartford R. Co.,** 92 F 2d 428, 430; certiorari denied 303 US 650.

Hence, this rule governs in reorganization proceedings under § 77, for by force of subsection (b) thereof unsecured claims in § 77 proceedings are entitled to the same priority as that accorded in equity receiverships. The legislative intent in this connection is emphasized by the fact that the class of exceptions entitled to priority has been carefully regulated and has been enlarged by Congress in Section 77 to include only two additional classes of cases. These enlargements, created by subsection (n), are:

(1) Employees' claims in § 77 proceedings for personal injury.

(2) Surety claims in § 77 proceedings payable by sureties on supersedeas and like bonds.

By Act of Congress approved August 11, 1939, 53 US Stat. 1406, these two additional classes were accorded

priority in equity receivership cases, as well as in § 77 proceedings.

It is perfectly clear that petitioner's unsecured claim is not within the class entitled to priority by virtue of the exceptions created in **Fosdick v. Schall** nor within the enlargement of those exceptions created by § 77 itself. The basis of the rule that benefit to the mortgagee is the controlling equitable consideration was again recognized by this Court in **New York Dock Company v. S. S. Poznan**, 274 US 117, at 121. The decision of the Court below is in complete accord with the decisions of this and all other federal courts which have passed on the question, as well as in accord with the governing statute. No occasion exists for the issue of a writ of certiorari.

The statements on page 4 of the petition herein as to payments of dividends in the years 1930 and 1931 are irrelevant to any equitable considerations here. Those dividends were paid to stockholders of the old company who retained no interest whatever in the property after the debtor's reorganization. The payment of such dividends, if prejudicial to unsecured creditors, was equally prejudicial to secured creditors since they would have had a lien on the funds prior to the unsecured creditors, if the funds had been retained as assets of the debtor.

POINT II.

Petitioner's Specification of Errors Is Without Substance.

Petitioner's first and second specifications of error relate to the principal question involved in this case. For the reasons stated in the foregoing portion of this Reply Brief, the decision of the Court below was in accord with the decisions of this Court and the provisions of the governing statute. These specifications of error are, therefore, entirely without substance.

Petitioner's third specification of error, taken in conjunction with the argument in support of the specifications, seems to be a confusion of the question of **what claims are entitled** to priority with the question of **what funds are subject to the payment** of priority claims. The reference to and the argument based on **Gilman v. Illinois and Mississippi Telegraph Co.**, and **United States Trust Co. v. Wabash Western Ry.**, on page 15 of petitioner's brief are obscure and uncertain. They seem to constitute a contention either (a) that there was a diversion of pre-receivership income constituting a current debt fund for the payment of priority claims, or (b) that the order for impounding and sequestration of income was not seasonably entered, leaving as unmortgaged assets certain income accruing prior to the impounding and sequestration order. But neither aspect demonstrates any error in the decision of the Court below or calls for the issuance of a writ of certiorari.

It is true that there is much discussion in the decisions of this Court and other federal courts with respect to the fund out of which priority claims may be paid.[1] It has been pointed out that:

> "The funds to which such priority attaches are unmortgaged property, pre-receivership operating income either on hand or subsequently collected by the receiver, net receivership operating income, and the corpus of the mortgaged property to the extent, but only to the extent, that pre-receivership or receivership income has been diverted for the benefit of the mortgage creditors." **The Present Status of the Six Months' Rule**, T. O'G. Fitzgibbon, 34 Col L R 230, 241-242.

But petitioner's argument in this regard rests upon a misconception of the priority rule in relation to the fund

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1 See cases cited in **The Present Status of the Six Months' Rule**, T. O'G. Fitzgibbon, 34 Col L R 230, 241-242.

out of which priority claims may be paid or satisfied. The so-called "current debt fund" is not subject to payment of petitioner's claim unless the claim has priority based upon some superior equity or statutory provision. A general unsecured claim becomes a charge on the "current debt fund" if, and **only if,** it has a superior equity or statutory foundation entitling it to priority. Petitioner's reasoning in this connection begs the question by assuming in the premise the desired conclusion. In short, it "puts the cart before the horse." The fallacy which leads to this illogical result was the main contention which petitioner pressed below, namely, that **all** operating expenses are entitled to priority; whereas in truth only operating expenses incurred **for the benefit of the estate** are within the rule. See **Fosdick v. Schall,** supra, and **Burnham v. Bowen,** supra, and **Pennsylvania Steel Co. v. New York City Ry. Co.,** 216 F 458, at 472-473, certiorari denied, 238 US 632.

On the other hand, if petitioner's argument means that the date of the entry of the impounding order was such as to leave certain income available as an unmortgaged asset for the payment of unsecured claims, petitioner's argument fails on two grounds: **First,** because it is **res judicata** that there were no unmortgaged assets available for the satisfaction of unsecured claims; and **second,** for the reason that the existence of a priority claim is not dependent upon the existence or non-existence of unmortgaged assets, as shown above, p. 8.

If petitioner now contends again that the claim at bar must be paid because of the existence of unmortgaged assets, that contention, besides being a complete abandonment of the legal basis of the claim urged in the District Court and the Court below and unsupported by the pleadings, was adjudicated adversely to petitioner on the appeal to the Court below from the District Court's order approv-

ing the plan of reorganization for respondent. The substance of petitioner's contention at that time and the disposition made of it by the Court below are set forth in **Brooks v. St. Louis-San Francisco Railway Company**, 153 F 2d 312, at 317, certiorari denied, 328 US 867-868, and need not be repeated here.

On the other hand, in the reorganization proceedings the question whether the claim at bar is entitled to priority was reserved for later determination. The case at bar is the result of that determination, which was, as held by the District Court and the Court below, that the claim has no priority. For the reasons stated hereinbefore, that determination was in accord with the decisions of this Court and with the applicable provision of Section 77.

CONCLUSION.

There is no ground shown for granting a writ of certiorari in the case at bar, and the petition for certiorari should be denied.

Respectfully submitted,

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St. Louis, Missouri,
May 11, 1950.

APPENDIX.

Prior to its amendment in 1939, subsection (n) of Section 77 reads as follows:

> "In proceedings under this section, claims for personal injuries to employees of a railroad corporation, claims of personal representatives of deceased employees of a railroad corporation, arising under State or Federal laws, and claims now, or hereafter payable by sureties upon supersedeas, appeal, attachment, or garnishment bonds executed by sureties without security for, and in any action brought against such railroad corporation or trustee appointed pursuant to this section, shall be preferred against and paid out of the assets of such railroad corporation as operating expenses of such railroad." 49 US Stat. 923, Approved August 27, 1935.

The Act of August 11, 1939, amended subsection (n) to read as follows:

> "In proceedings under this section, and in equity receiverships of railroad corporations now or hereafter pending in any court of the United States, claims for personal injuries to employees of a railroad corporation, claims of personal representatives of deceased employees of a railroad corporation, arising under State or Federal laws, and claims now or hereafter payable by sureties upon supersedeas, appeal, attachment, or garnishment bonds, executed by sureties without security, for and in any action brought against such railroad corporation or trustees appointed pursuant to this section, shall be preferred and paid out of the assets of such railroad corporation as operating expenses of such railroad." 53 US Stat. 1406, Approved August 11, 1939.